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FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

NEW CHALLENGES FOR STATE BANK REGULATORS

An address by

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of the
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I am honored to appear before you once again and to have the opportunity to discuss the problems and challenges facing bank regulators in our efforts to maintain a sound, progressive banking system.

Since our last meeting, dramatic changes in our financial system have continued, if not accelerated. We are at a crossroads in the evolution of the nation's financial institutions, and some difficult choices must be made. These choices will determine the direction and strength of our country's financial system for decades to come.

Let me begin by telling you about our recent actions in dealing with troubled thrift institutions, for we must confront the problems of today before we can undertake the task of developing for tomorrow a new regulatory climate in which depository institutions are able to compete and prosper. Then I will turn to some of the longer-range, structural issues with particular emphasis on some issues directly relevant to the survival of our dual or state/federal banking system.

I. The Current Thrift Problems

There is no need for me to belabor the current thrift problems as they are well known to all of you. Our principal concern and common goal must be to maintain public confidence in the safety and soundness of all financial institutions. We no longer have the luxury -- if we ever did -- of simply waiting for the return of an economic environment in which lower inflation and stable interest rates resolve the problems for us.

During the last few months, as the surplus positions of some of the nation's largest mutual savings banks became seriously depleted, the FDIC and several state bank supervisors were confronted with the alarming prospect of having to close a number of those institutions and pay off insured depositors. Such an event could have caused irreparable damage to public confidence in the safety of deposited funds, affecting not only other thrift institutions but all financial intermediaries. Instead, our approach has been to provide financial assistance to facilitate the acquisition of seriously weakened institutions. This assistance has not been intended as a stopgap measure; rather, it has been granted to insure that the resulting institution will be a financially sound, viable competitor. We have endeavored to strengthen the financial system while maintaining a high level of public confidence.

I cannot tell you that all of the problems are behind us. Operating losses in insured mutual savings banks, which reached epidemic proportions in 1981, continue at unacceptable levels. This trend will not be reversed until interest rates are stabilized at significantly lower levels. While solutions to the underlying economic problems lie beyond our control as bank regulators, we must continue to take positive, constructive actions with the tools we have at our disposal, and to work with Congress and state legislatures in an attempt to gain the additional flexibility necessary to deal with the situations still ahead.

We take satisfaction in the accomplishments to date. They could not have been achieved, however, without the close cooperation of state bank supervisors, other federal regulatory agencies and industry officials. The recent merger transactions involving the Farmers & Mechanics Savings Bank in Minneapolis and the Fidelity Mutual Savings Bank in Spokane serve as notable examples of situations in which such cooperative efforts resulted in sound, innovative solutions.

The bidding process for the $1 billion Farmers & Mechanics was facilitated by the rapid passage of special legislation in Minnesota to allow the acquisition of that institution, as a commercial bank, by an out-of-state bank holding company under Section 3 of the Bank Holding Company Act. The use of a competitive bidding process, which included both in-state and out-of-state potential acquirers, resulted in a substantial savings -- in excess of $50 million -- for the FDIC and, consequently, for the banking system as a whole. Commissioner Mike Pint and his staff are to be especially commended for their response to this problem. CSBS itself played an important role in helping us obtain swift adoption of the Minnesota legislation.

The FDIC-assisted merger last month of the $700 million Fidelity Mutual Savings Bank in Spokane once again illustrated the value of a competitive bidding process that included out-of-state as well as in-state firms. The participation of potential acquirers in states nearby Washington resulted in a savings to the FDIC of more than $20 million.

We believe events have demonstrated clearly that a competitive interstate bidding process is an essential tool that should be available to the FDIC in dealing with large, troubled institutions. Our record shows this tool can and will be used in a responsible fashion.

The nine assisted savings bank merger transactions to date have been a learning experience for all of us. We sincerely appreciate the help and support provided by various state supervisors and their staffs.

Short of a dramatic turnabout in the economy and interest rate environment, there is no panacea for the problems facing the thrift industry. In recent months, virtually everyone concerned about the condition of the thrifts has advanced proposals for resolving the current dilemma.

Unfortunately, a number of these proposals are aimed at only one aspect of the problem and fail to address the underlying structural weaknesses. So-called "bail-out" plans, for example, can at best provide but temporary relief. In our judgment, a subsidy, standing alone, would be highly undesirable.

A comprehensive approach to the current situation is needed, one that comprises several elements. First, as many of you know, we have been quite vocal for some time now in calling for enactment of the Regulators' Bill. Its passage would expand our options in dealing with failing institutions and would result in substantial savings to the insurance fund and ultimately to the banking community. Although the recent transactions in Minnesota and in Washington were successfully accomplished without federal legislation, the limitations of current law made them exceedingly complex and cumbersome to effect. Those experiences underscore the need for Congressional action and policy direction in this uncharted area. We will soon be resubmitting an updated version of the Regulators' Bill, and I ask your continued support for its prompt enactment.

Second, enactment of something akin to the Garn Bill is essential to override state usury ceilings and due-on-sale prohibitions and to expand thrift asset powers. This legislation is needed to deregulate the asset side of the balance sheet as we phase out the controls on what banks and thrifts can pay for liabilities. The legislation would make it easier and less expensive for us to handle failing thrifts while enabling the survivors to become stronger, more viable financial intermediaries.

Third, we need to continue the process of interest rate deregulation. The phaseout of deposit interest rate ceilings has been an area of ongoing controversy for several years. While the Depository Institutions Deregulation Committee has a mixed record, I am heartened by the adoption of the 3½-year phaseout schedule at the last DIDC meeting. What is still urgently needed is a competitive, short-term instrument to reverse the outflow of deposit dollars to money market funds and other intermediaries.

Fourth, some accounting changes may be appropriate. Our staff is looking closely at possible accounting reforms, such as moving from a historic-cost based system to a current-value based system to give institutions a greater ability to restructure their asset portfolios while discouraging continuation of the investment and funding practices that gave rise to the current problems. We hope to have some proposals on this subject in the not-too-distant future.

Finally, some states and localities continue to impose franchise taxes irrespective of whether a bank is profitable. Savings banks are simply incapable of carrying this burden given current conditions, and we urge local regulators to lobby aggressively for abolition or curtailment of these taxes.

II. The Challenge to Our Dual Banking System

In my address to your convention last year, I focused on the challenge to our dual banking system resulting from enactment of the 1980 Monetary Control Act. That law equalizes, over a period of years, the reserve burden imposed on state and national banks. I warned that one consequence might be that state banks would begin to question the desirability of remaining state chartered, particularly if the burden of dual regulation were not reduced substantially.

We are beginning to see some evidence that a trend toward selection of national charter is occurring. During 1979, for example, 53 national banks converted to state charters, while only one state bank converted to national charter. Contrast that to 1981, in which 23 state banks converted to national charters, while only 12 national banks converted to state charters. Looking at new banks in 1979, 283 state banks were chartered, compared to only 79 national banks. In 1981, 112 national banks were chartered compared to 124 state banks. The rush toward state charters has clearly subsided; indeed, there is already some movement in the other direction, even though it will be several more years before the reserve burden is fully equalized.

As you well know, I have long been a proponent of our dual banking system. It permits local, as opposed to national, jurisdiction over state-chartered institutions. This brings government closer to the governed and provides a healthy counterbalance to excessive concentration of power at the federal level. Perhaps the greatest justification for our dual banking system, though, is the potential it holds for developing a multiplicity of innovative approaches to banking problems and issues.

The banking industry is facing major challenges today on two fronts. First, the economy is troubled and turbulent. Second, the competitive environment is becoming intense. Under these circumstances, excessive and inefficient regulation has become intolerable. Astute bankers, quite understandably, are demanding that every significant aspect of the regulatory system be either justified anew or abolished.

The state banking system has experienced numerous ups and downs over the past two centuries. It has miraculously survived even deliberate attempts to abolish it in favor of a unified national system.

In my judgment, we are entering another crucial testing period. The state banking system could easily, through neglect, wither away over the next decade or two. Or it might, with a great deal of effort on the part of many people, be invigorated.

I am not certain of the outcome. However, I believe I can identify the factors that will determine the ultimate fate of the state banking system. Those factors are: the degree to which state banks are deregulated and the rapidity of the deregulation process.

There are two distinct types of deregulation which must take place if banks are to remain viable in the 1980s and beyond. State banking authorities have the opportunity to lead the way along both avenues. If they do, the state banking system will be revitalized and given a new lease on life. If the states fail to move forward, more than a few questions will be raised regarding the continuing justification for the dual banking system.

The first form of deregulation is defensive in nature. It involves streamlining our regulatory procedures to achieve maximum efficiency and reducing the regulatory burden. The second form of deregulation is offensive in nature. It involves granting banks authority to offer a broader range of financial services in geographic markets of their choice.

A. <u>Reducing the Burden of Regulation</u>. Although much remains to be accomplished, we -- the states and the FDIC -- have already made significant progress toward the goal of streamlining procedures and reducing the burden of regulation. Let me give a few examples.

Our experience to date with the Divided Examination Program, whereby the FDIC and state authorities alternate in the examination of institutions and share examination reports, has been quite successful. This program not only reduces the burden on banks, it allows both state regulators and the FDIC to employ their resources more efficiently. Currently, 27 states participate in this program, an increase from 18 states last year. The program now covers more than 4,613 banks and saves the FDIC, state authorities and the banks under their jurisdiction millions of dollars each year.

We are also planning increased use of off-site surveillance for monitoring balance sheet relationships and earnings trends, while at the same time decreasing the burden of frequent full-scope, on-site examinations. Such efforts will permit us to concentrate on troubled institutions and on specific problem areas. This will result in a reduction of the number of days that our field examiners remain on the bank premises and a lengthening of the examination cycle for those institutions with a history of sound performance.

A major effort is underway to reform our entire applications process, which in the past has been a time-consuming, expensive and sometimes frustrating experience for bankers. We have substantially simplified and shortened our application forms. The development of "core" application forms has laid the groundwork for common applications to be made to both the state authorities and the FDIC. Currently, 27 states have joined us in this program. Applications are being processed simultaneously by the FDIC and most states, which further minimizes expense and delay.

We have delegated increased authority to our Regional Directors to approve applications, which again reduces expense and delay. Most recently, our Board of Directors delegated to the Regional Directors authority for approval of deposit insurance applications. Further delegations are contemplated with respect to mergers, and in the branching area we are working on a complete overhaul of our procedures.

Our Regulations Task Force is in the process of reviewing all of our regulations, eliminating those that are no longer needed and simplifying others. Each regulation must go through a cost/benefit analysis, and small bank exemptions must be utilized wherever feasible. We have urged, and will continue to urge, Congress to undertake a major revision of unduly burdensome laws such as Truth-in-Lending, FIRA and CRA.

We have instructed our examiners to use good judgment and common sense in enforcing the law. If a bank is attempting in good faith to comply with the law, our examiners will respond in a positive manner and try to help the bank improve its performance. Toward that end, we have conducted a nationwide series of seminars, attended by thousands of bankers, for the purpose of explaining and improving compliance with a wide range of laws and regulations.

I could go on, but I have probably said enough to make my point. We believe that banks -- particularly the smaller ones -- are operating under an excessive regulatory burden, and we intend to do everything in our power to alleviate it. We are also convinced that we can improve our effectiveness in bank supervision while at the same time reducing costs.

B. Expanding Bank Powers. The second form of deregulation -- giving banks greater authority to enter new geographic and product markets -- is far more important than the first area, but is also a far more difficult area in which to obtain progress. Each time it is proposed that banks be permitted more flexibility in a given area, potential competitors throw up innumerable legislative roadblocks.

This has stymied any substantial progress at the federal level. As a result, there is an opening for the state banking system to lead the way.

Bank competitors have evolved into full-service financial intermediaries. Sears is but one good example. It owns a savings and loan association, a major insurance company, one of the largest investment banking houses and a major real estate brokerage firm. It is also initiating a money market fund and has announced its intention to move into consumer deposit-taking and lending activities.

How can we justify a legal and regulatory system that permits Sears and others to engage in the full range of financial services while denying banks and bank holding companies comparable authorities? If Sears can own an S&L, on what basis do you deny the same authority to banks and bank holding companies? The same question must be asked with respect to the real estate brokerage, investment banking and insurance activities of Sears. If Sears can open convenient offices at locations of its choice, why should we deny the same right to banks?

In my opinion, the current disparities in regulation between banks and unregulated financial intermediaries are intolerable and will be rectified. Although it is possible that some new regulatory constraints will be placed on those who enter the deposit-taking field, I believe the basic thrust of public policy in the years ahead will be to grant banks and bank holding companies greater freedom to compete.

The question is whether the state banking system will lead the way or tag along as we enter banking's new era. I recognize that to a certain degree your hands are tied by federal laws which limit your ability to respond. Nevertheless, I believe you ought to be exploring avenues for broadening the authority of banks and bank holding companies to enter new geographic and product markets so long as the activities are financially-oriented and consistent with sound banking principles. The states are ideally situated to function as experimental labs in which new ideas can be tested. This allows experimentation, providing the opportunity to test and evaluate new approaches in banking on a limited scale.

I am convinced that the future of our dual banking system rests in your hands. If you join forces with us in reforming and simplifying our procedures, strengthening your departments and providing state banks greater competitive opportunities, the dual banking system will survive and prosper for decades to come. If you fail to respond to the current challenges, the state banking system will have been dealt a potentially crippling blow during its hour of need.

Let me thank you again for giving me this opportunity to appear before you.

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